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EX PARTE

February 4, 2003

ELECTRONICALLY FILED

Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket Nos. 01-338; Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 96-98; Appropriate Framework of Broadband Access to the Internet Over Wireline Facilities, CC Docket No. 02-33.*

Dear Ms. Dortch:

This letter, filed on behalf of AT&T Corp., responds to the January 15, 2003 *ex parte* letter of Edward Shakin, Vice President and Associate General Counsel of Verizon, submitted in the above-captioned proceedings ("*Verizon Small Business Letter*"). Notwithstanding the fact that Verizon and the other Bell Operating Companies supply the overwhelming majority of broadband services to small businesses, Verizon contends that the Bells are, in fact, "at a disadvantage" to cable providers in serving those customers.[1] And, notwithstanding the fact that cable networks do not even *reach* a sizeable percentage of small businesses, Verizon insists that the small business segment of the "broadband market" is fully "contestable" and that existing unbundling obligations are therefore "counter-productive."[2] As demonstrated below, Verizon misrepresents both the facts and the regulatory implications.

First, like previous Verizon submissions, this one completely ignores the relevant question in these proceedings of the *wholesale* alternatives available to requesting carriers (and

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[1] Verizon Small Business Letter at 2.

[2] *Id.* at 1.

ISPs) that seek to provide broadband services. As AT&T has repeatedly shown -- and as Verizon has not and cannot plausibly rebut -- the simple fact today is that neither competitive carriers nor ISPs can serve small businesses without access to the Bells' last mile facilities.[3] Cable companies do not even provide the type of voice and high-speed data access required by competing carriers, and, in any event, do not even have facilities that actually connect to most small businesses. And, although some cable companies have begun to provide some access to certain ISPs in some markets, there is no cable alternative for most ISPs in most markets, certainly not with respect to small business customers. Verizon's characterizations of broadband services available at *retail* to some small businesses provide no possible basis for any limitation on the incumbent LECs' obligations to unbundle, as wholesale offerings, the wireline facilities that serve all small businesses (or to provide nondiscriminatory access to ISPs).

Second, Verizon's letter only confirms that, using an appropriate market analysis, the Bells face virtually no retail competition in the provision of broadband services to small businesses. AT&T previously described the limited geographic scope of cable services,[4] and Verizon's letter confirms this analysis. Verizon claims that cable operators' "existing infrastructure" can reach "most" small businesses, but its own analysis rebuts that claim.[5] Verizon indicates that, of an estimated 10.5 million small and medium businesses, only 2.5 million are passed by cable infrastructure today.[6] That is, Verizon *concedes* that for 76% of small businesses, the incumbent LEC faces *no* significant competition in the provision of broadband services. Verizon predicts that cable companies could reach an additional 3.5 million small businesses with "moderate extensions" of their networks, but makes no attempt to demonstrate that cable companies are actually making the massive investments necessary to do so. To the contrary, as Verizon notes, not all cable operators are even targeting business customers.[7] But even if cable systems could economically (and did, in fact) significantly expand their networks as Verizon suggests, they would pass barely *half* of small businesses.

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[3] Letter from David Lawson, Sidley & Austin, to Marlene H. Dortch, submitted in CC Docket Nos. 01-337, 96-98, 98-147, and 96-149 (Dec. 23, 2002) ("Lawson Letter"); AT&T Reply Comments, *Review of the Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket 01-337, at 19-50 (March 1, 2002) ("AT&T Broadband Reply Comments"); AT&T Comments, *Review of the Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket 01-337, at 4-26 (April 22, 2002) ("AT&T Broadband Comments").

[4] *See* AT&T Broadband Comments at 15-16, 42-43; AT&T Broadband Reply Comments at 5-8; Lawson Letter at 6-7.

[5] Verizon Small Business Letter, at 3.

[6] *Id.*

[7] *Id.* at 2. Indeed, broadband competition from cable operators depends upon the pace of their infrastructure upgrades, and two systems – Time Warner and Cox Business Services, with a

Third, even if only retail competition were relevant and even if the Commission examined only the minority of small businesses actually passed by cable infrastructure, Verizon's analysis confirms that Bells do not face effective competition that would constrain abuses of market power. Even for those customers, cable companies and the Bells would be the only effective providers of broadband services, which is merely a "stagnant duopoly" that the Commission has recognized would not be sufficient to provide effective competition.[8]

Fourth, Verizon's analysis does not assess competition as it currently exists, but only as it may eventually develop on a yet-to-be-determined schedule to a yet-to-be-determined scope. Thus, cable companies are portrayed as "moving aggressively" to provide cable modem services to small businesses, having recently "formed separate business units" that are "setting [their] sights" on capturing business customers and having customers within reach if only they expand their networks.[9] Similarly, Verizon states that direct broadcast satellite providers have "introduced" services designed for businesses, and fixed wireless and "other emerging technologies" are "potential alternatives in many areas."[10] And it claims that frame relay providers "could" provide degraded versions of their products, and that small businesses are spending "$55 *million* annually" on frame relay services (compared to $5 *billion* in annual spending by small business customers for wireline data services).[11] Although industry analysts are free to speculate about *potential* growth that *may* occur in various service sectors, as they did without constraint during the Internet bubble, it would plainly be arbitrary for the Commission to accept Verizon's invitation to rely on bubble-era hypotheses to form policy that would ignore the very real impairments that requesting carriers face today in serving small business customers.

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combined total of only 80,000 business subscribers – have a substantial lead over other systems in converting their systems and acquiring business customers using business-grade offerings. *See* Yankee Group, *Cable MSOs: Ready to Take Off in the Small and Medium Business Market*, at 13 (2002) ("Cable Report").

[8] *See UNE Remand Order*, 16 FCC Rcd 1724, at ¶ 55 (1999). AT&T has provided evidence that the ILECs' DSL pricing is not constrained by market forces. *See, e.g.*, AT&T Broadband Comments, at 45-47.

[9] Verizon Small Business Letter at 2, 3 n.10 (internal quotation omitted).

[10] *Id.* at 2.

[11] *Id.* at 6-7. In-Stat/MDR, *The Data Nation: Demand for Broadband and Data Services in the Small Business Market*, at 15 (Oct. 2002) ("Small Business Broadband Report") ($4.79 billion in 2002, $5.48 billion in 2003). Even if these services could become material to the small business market, competing carriers that provide frame relay and ATM services require the ILECs' special access services as inputs, ensuring that the ILECs retain ultimate control of the competitiveness of these retail services.

Even apart from these basic analytical flaws, Verizon considerably overstates the importance of particular sources of competition to the Bells' small business broadband offerings. The cable services provided to small businesses are primarily residential-grade services provided in residential areas to the very smallest home and branch-office businesses. Beyond these residential areas, and especially for business-grade services or services to main offices of small businesses, cable MSO penetration is exceptionally limited. And as for satellite, fixed wireless, and other "potential" services noted by Verizon, they simply are not material competitors today and do not have any prospect of becoming material competitors any time soon.

Cable. Cable operators provide limited retail broadband competition for small businesses, and this competition depends overwhelmingly upon consumer grade services, especially those provided to residences. Industry experts predict that "cable modem service will remain largely a residential experience."[12] With respect to commercial grade broadband services and services provided to offices rather than to homes (or home offices), the ILECs' DSL services dominate and cable poses a quite limited competitive threat.

Total small business broadband subscribers among businesses of fewer than 100 employees exceed 2.7 million.[13] Of these, cable service providers serve fewer than 330,000 commercial-grade (as opposed to residential-grade) subscribers, compared to more than 790,000 such DSL subscribers (a 70% share even ignoring T1 and other Bell broadband offerings to small businesses).[14] Likewise, nearly three-fourths of main office (as opposed to branch office or home office) subscribers purchase their small business broadband services from DSL providers.[15] "DSL services have an incredibly bright future among small business customers,"[16] and "research suggests that DSL services will continue to outstrip cable to become the undisputed leader in adoption among main office locations in smaller firms."[17] In contrast, cable subscribers in the small business segment are concentrated in homes.[18] Fewer than 25% of small business broadband cable subscribers received commercial-grade as opposed to residential-grade

[12] In-Stat/MDR, *Broadband 2002: DSL and Cable Modem Services Fuel Worldwide Subscriber Growth*, at 21 (June 2002) ("Broadband 2002").

[13] In-Stat/MDR, *Small Business Broadband Report*, at 23.

[14] *Id.*

[15] *Id.* at 24-25.

[16] *Id.* at 24.

[17] In-Stat/MDR, *All Access: Internet Access in the Small Business Market*, at 13 (Nov. 2002) ("Internet Access Report").

[18] In-Stat/MDR, *Small Business Broadband Report*, at 25.

service.[19] "[T]he target market for the cable MSO will be very small businesses – those with 2 to 19 employees."[20]

The reliance on residential service and home-based subscribers is even more apparent for slightly larger small businesses, *i.e.*, those with 100 to 999 employees, which included approximately 1.15 million broadband subscribers in 2002.[21] For this segment, compared to cable, DSL serves *55 times* the number of subscribers in main offices (a 98% share) and 12 times the number for branch offices (a 92% share).[22] And more than 95% of cable subscribers in this segment receive residential-grade rather than commercial-grade services.[23]

The Yankee Group notes that "current [cable] services are limited" and that "MSOs have attained approximately 106,000 subscribers with business-grade offerings," with 456,000 subscribers to consumer-grade offerings.[24] The Yankee Group notes that considerably more infrastructure upgrades would be needed to enable cable operators to match DSL offerings, and it identifies a number of infrastructure upgrades factors that will continue to limit MSO service provision to businesses, including: (i) "[c]able MSOs are hindered by the fact that they are currently viewed as consumer-grade companies;" (ii) "[o]verall management functions – like billing, provisioning, and operations support – are not sufficient to support varying business grade services on a large scale;" and (iii) "[b]ecause the cable footprint is still limited, it is not cost-effective to build out the coax to reach all of these businesses. In many areas where cable does pass the building, the MSO may not have building rights, which presents additional barriers to the business market."[25]

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[19] *Id.,* at 23.

[20] Yankee Group, *Cable MSOs Get Down to Business,* at 8 (Feb. 2002).

[21] InStat/MDR, *The Data Nation: Demand for Broadband and Data Services in the Middle Market*, at 23 (Oct. 2002).

[22] *Id.* at 24-25.

[23] *Id.*

[24] The Yankee Group, *Cable Report,* at 6.

[25] *Id.* at 7, 13. Verizon argues that the market is "contestable" and "nascent" because business customers "make up less than a fifth" of ILEC DSL customers. Verizon Small Business Letter at 2. The statement is a *non sequitur*, because a small percentage of the ILECs' total customer base may be – and is – a very large percentage of small businesses that buy broadband services. *See supra* at 4-5. In any event, "only around 5% of the average cable operator's total cable modem subscribers were businesses," In-Stat/MDR, *Broadband 2002*, at 21, and the scope of cable systems is considerably less than the near ubiquity of ILEC networks.

Satellite. Broadband competition in the small business segment from satellite providers is, for all practical purposes, non-existent. Indeed, satellite service providers actually solidify the Bells' dominance, because "the most recent trend for satellite broadband services has been to offer a bundled DBS pay-TV service with a *DSL broadband data service* marketed by the DBS provider, but actually *provisioned by the local ILEC*."[26]

Apart from satellite providers' resale of ILEC DSL services, their total presence in the market is miniscule, as the two service providers highlighted by Verizon illustrate. Hughes Networks' Directway is estimated to serve 200,000 subscribers at the end of 2002, but these are overwhelmingly residential subscribers and the equipment costs are characterized as "ridiculously steep."[27] The satellite service that Hughes hopes will solve these problems will not even be available until new satellites are launched, and even then, the new service is expected to target the enterprise business segment rather than small businesses.[28] StarBand, the other satellite provider that Verizon highlights, filed for bankruptcy in June 2002 after EchoStar scaled back its support and Echostar Chairman and CEO Charlie Ergen frankly admitted that "broadband has probably been our biggest disappointment."[29] StarBand has been seeking funding, recently engaged in a broad firing that reduced its employees to 140,[30] and, according to experts, "has ground to a halt."[31]

There is also no likelihood that the satellite situation will change materially in the foreseeable future. Impediments include high monthly service costs, high equipment and provisioning costs, and poor quality of service because of "the inherent latency and bandwidth constraints of a satellite-based data service."[32] The roll call of satellite providers that have scaled back or delayed their services confirms these impediments, as well as broader difficulties related to capital funding and infrastructure development: Astrolink (Lockheed Martin has abandoned its participation); SkyBridge (cancelled LEO strategy in 2002); Teledesic (scaled back and delayed offering); and WildBlue ("still stalled on the launch pad").[33]

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[26] In-Stat/MDR, *Broadband 2002*, at 50 (June 2002) (emphasis added).

[27] *Id*. at 54; *see also* Yankee Group, *2002 Broadband Subscriber Forecast*, at 4 (2002) ("the high cost of both hardware (approximately $500) and monthly subscription fees ($70) makes satellite significantly more expensive than the sub-$100 modems and $40-$50 subscription fees for DSL and cable modems").

[28] In-Stat/MDR, *Broadband 2002*, at 54.

[29] *Id.*

[30] "StarBand Lays Off 36, Including President," Washington Post, p. E-5 (Sept. 11, 2002).

[31] In-Stat/MDR, *Broadband 2002*, at 53.

[32] *Id.* at 50; *see also* Yankee Group, *2002 Broadband Subscriber Forecast*, at 4.

[33] In-Stat/MDR, *Broadband 2002*, at 53-55.

Other "potential" competitors. Even Verizon does not attempt to document that other broadband service providers, such as fixed wireless, WiFi technology, or VSAT services, have any near term potential to capture a material portion of the small business broadband market. Nor could they. DSL and cable services "represent more than 95% of all business broadband subscribers in the US market."[34] Thus, neither "WiFi" nor "VSAT" technologies can today be considered serious competitive constraints. WiFi "as it stands today, has severe limitations that hinder its viability as a broadband access platform for carrier class network-based solutions."[35] Although it "*perceives* a market" for its new WiFi switch, Vivato, Verizon's WiFi standard-bearer, has not yet even released a product.[36] And VSAT (or "very small aperture terminal") is a highly specialized two-way satellite offering that is not even targeted at small businesses.[37]

Thus, there is overwhelming evidence that the Bells dominate – and will continue to dominate – in the provision of broadband services to small businesses.[38] Offerings by satellite, fixed wireless, and other emerging technologies are so limited to be irrelevant to any review of overall competition in this sector. And as a recent survey reveals, cable offerings likewise represent a tiny share of services: 0% share of main and branch offices for businesses with 50 to 99 employees, 10% of main offices for companies with 5-49 employees, and only 14% of home offices of small businesses (5-99 employees).[39]

In sum, any careful examination of Verizon's small business evidence simply confirms that nothing about competition in the small business market justifies the regulatory relief that

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[34] In-Stat/MDR, *SmallBusiness Broadband Report*, at 22.

[35] XDSL.com, *TeleChoice Broadband Wireless Study Redefines Broadband Data Marketplace* (Jan. 15, 2003) http://www.xdsl.com/ newsreleases/view.asp? newsid=169212.

[36] Peter Cohen, *Vivato's 'WiFi Switch' Provides Large Scale Coverage*, MacCentral (Nov.4, 2002), http://maccentral.macworld. com/news/0211/04.vivato.php (emphasis added); http://www.vivato.net/prod_ tech_overview.html.

[37] January 16, 2003 Press Release of Gilat Satellite Networks Ltd., http://www.gilat.com/PressRoom_PressRelease.asp?sbj=499 ("US subsidiary Spacenet Inc. has signed multiple agreements with global lottery services leader GTECH Corporation to install more than 10,000 Gilat Skystar Advantage® broadband satellite communications terminals for lottery networks in California, Minnesota, Kansas and New York").

[38] "The variety in the types of DSL services becoming available, coupled with the fact that DSL services are provided by several of the incumbent phone companies with which small businesses already have a relationship, suggests that these customers may be more inclined to adopt these services than other alternatives when availability improves." In-Stat/MDR, *Small Business Broadband Report* at 24 (Oct. 2002).

[39] *See* In-Stat/MDR, *Internet Access in the Small Business Market*, at 13-18 (Nov. 2002).

Verizon and the other Bells seek. No relevant wholesale competition exists, and most small business customers do not even have retail alternatives to the Bells' broadband offerings.

One electronic copy of this notice is being submitted to the Secretary in accordance with section 1.1206 et seq. of the Commission's rules.

Sincerely,

/s/ David L. Lawson

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